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No. 84-1076

IN THE

Supreme Court of the United States

OCTOBER TERM, 1984

TRANSCONTINENTAL GAS PIPE LINE CORPORATION,
Appellant,

v.

THE STATE OIL AND GAS BOARD OF MISSISSIPPI and COASTAL EXPLORATION, INC., *et al.*,
Appellees.

On Appeal from the Supreme Court of Mississippi

MOTION OF COASTAL EXPLORATION, INC. TO FILE SUPPLEMENTAL BRIEF AFTER ARGUMENT AND SUPPLEMENTAL BRIEF

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December 9, 1985

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Coastal Exploration, Inc. ("Coastal"), Appellee, moves the Court pursuant to Rule 35.5 to allow it to present by Supplemental Brief a certain intervening matter that was not available in time to have been included in Coastal's brief in chief, being a matter which has intervened since the oral argument of this case on October 8, 1985, as follows:

1. Appellant Transco's brief in chief (at pages 14-15) and the brief of the FERC (at pages 21-22) refer to inquiries which the FERC has opened into Transco's purchases of gas, and represent that Mississippi's ratable take requirement, at issue, may conflict with or frustrate the FERC's exercise of its jurisdiction under NGPA § 601(c)(2), a claim which Coastal dis-

putes. On October 31, 1985, the FERC issued an Initial Decision in *Transcontinental Gas Pipe Line Corporation*, FERC Docket No. TA85-3-29-008, which finds, *inter alia*, that "Transco's purchase practices of volumes from the Greens Creek and East Morgantown Fields have not been imprudent and have not resulted in unjust and unreasonable rates." *Id.* at page 7.

2. The Court should be advised of this intervening matter as more fully set forth in the accompanying Supplemental Brief.

WHEREFORE, PREMISES CONSIDERED, Coastal moves the Court for leave to file a Supplemental Brief in order to present the foregoing intervening matter.

THIS, the 9th day of December, 1985.

Respectfully submitted,

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Appellees.

On Appeal from the Supreme Court of Mississippi

SUPPLEMENTAL BRIEF IN SUPPORT OF MOTION OF COASTAL EXPLORATION, INC. TO FILE SUPPLEMENTAL BRIEF AFTER ARGUMENT

Appellant Transco's brief in chief (at pages 14-15) and the brief of FERC (at pages 21-22) refer to inquiries which the FERC has opened into Transco's purchases of gas. In their respective briefs, Transco and FERC represent that Mississippi's ratable take requirement, at issue, may conflict with or frustrate the FERC's exercise of its jurisdiction under NGPA 601(c)(2), a claim which Coastal disputes.

Additionally, at the oral argument of this case on October 8, 1985, the FERC implied that payment of the price ordered by the Mississippi Supreme Court

might constitute fraud or abuse and thus FERC might prohibit Transco from passing through these gas costs. Witness the following excerpts from the oral argument of Jerome M. Feit, Solicitor, Federal Energy Commission:

> But, in addition to that kind of scheme—in addition to that, FERC did have specific authority under Title VI of the Natural Gas Policy Act to prohibit the pass through of such gas costs which is found to be the product of fraud, abuse, or similar grounds.
>
> So, what you had was just the opposite of a commission of state intervention. You had a free market under Title I which FERC could not interfere with as you pointed out in the Mid-Louisiana opinion. And, on the other hand, you had FERC's control to assume that gas costs—that pricing practices of pipe lines are not fraud, abusive, or invalid on similar grounds from passing through. That is the Natural——
>
> Question: Would you fit this under the fraud or abuse section?
>
> Mr. Feit: I don't know if—My point is the power exists. I don't know whether in fact this amounts to fraud or abuse or similar grounds. It seems to me——
>
> Question: The power only exists if it does amount to that.
>
> Mr. Feit: Well, the power to impose denial to pass through exists.
>
> Question: Right.

Transcript of Oral Argument of October 8, 1985, at pp. 16-17.

In this connection, Coastal wishes to bring to the Court's attention FERC's Initial Decision issued October 31, 1985 in *Transcontinental Gas Pipe Line Corporation,* FERC Docket No. TA85-3-29-008. Considering the identical factual situation posed in Transco's and FERC's briefs and at oral argument by FERC counsel, the Initial Decision of FERC found, *inter alia,* that "Transco's purchase practices of volumes from the Greens Creek and East Morgantown Fields have not been imprudent and have not resulted in unjust and unreasonable rates." *Id.* at page 7. Attached as an Appendix is a copy of the FERC opinion.

DATED, this the 9th day of December, 1985.

Respectfully submitted,

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APPENDIX

APPENDIX

UNITED STATES OF AMERICA
FEDERAL ENERGY REGULATORY COMMISSION

Docket No. TA85-3-29-008

(Purchase Practices—Mississippi-Louisiana Issue)

TRANSCONTINENTAL GAS PIPE LINE CORPORATION

INITIAL DECISION

(October 31, 1985)

APPEARANCES*

R. V. Loftin, Jr., Thomas E. Skains, David A. Glenn, Thomas F. Ryan, Jr., Robert G. Hardy, and *Michael J. Fremuth* for Transcontinental Gas Pipe Line Corporation

Frederick Moring, Joseph M. Oliver, Jr., and *M. Lisanne Crowley* for Associated Gas Distributors

Sandra Delude, Kenneth M. Ende, Lawrence W. Lebow, and *Daniel Watkiss* for the Staff of the Federal Energy Regulatory Commission

MEGAN, Presiding Administrative Law Judge

I. INTRODUCTION

This proceeding presents the age-old conflict between state and federal regulation of commerce. The situation is this: Transcontinental Gas Pipe Line Corpora-

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* Other counsel have made appearances in Docket No. TA85-1-29-005 involving the first phase of this proceeding designated the Sulpetro Issue. *See* 32 FERC ¶ 63,081.

tion (Transco) operates a major natural gas transmission system. From its sources of supply in Texas, Louisiana, Mississippi and the Gulf of Mexico, the Transco system extends through the southeastern United States and up the eastern seaboard to its terminus in the New York City-Long Island area. Through its distributor customers, Transco serves many of the major market areas of the eastern United States, including Atlanta, Washington, D.C., Philadelphia and New York City.

One of the sources of supply of gas in Mississippi is the Harper Sand Gas Pool in the Greens Creek and East Morgantown fields in Marion County. In these fields, all of the production from the Harper Sand Gas Pool is below 15,000 feet and thus "high cost gas" under section 107(c) of the Natural Gas Policy Act (NGPA), 15 U.S.C. § 3317(c) (1982). Transco has executed purchase contracts with some, but not all, producers who own a working interest in the Harper Sand Gas Pool. Most, if not all, of Transco's contracts contain take-or-pay clauses. These clauses require a pipeline to purchase a specified minimum quantity of gas, or in any event to pay for that minimum quantity of gas if it is made available by the producer and not taken by the pipeline. Most take-or-pay provisions include a "make-up right" under which the purchaser is entitled at a later time to receive those gas volumes paid for but not previously taken.

In an enforcement proceeding brought against Transco, the State Oil and Gas Board of Mississippi, acting pursuant to Statewide Rule 48 (a ratable take rule), ordered Transco to take gas ratably from all owners, operators or producers in the Harper Sand Gas Pool. That rule provides:

> Each person now or hereafter engaged in the business of purchasing oil or gas from owners, operators, or producers shall purchase without discrimination in favor of one owner, operator, or producer against another in the same common source of supply. Miss. Code Ann. § 53-1-1 (1972).

Under this rule, if Transco takes gas at any time from the Harper Sand Gas Pool from producers with whom it has contracts (signatory producers), it is also required to take from producers with whom Transco does not have contracts (non-signatory producers), gas in volumes that equate to the same percentage of each producer's working interest in the Harper Sand Gas Pool. In effect, Transco has been ordered to take more high cost gas than it has contracted or planned for. On the other hand, if Transco were to reduce its takes from non-signatory producers, Transco would incur take-or-pay liabilities to those signatory producers whose contracts contain take-or-pay clauses.

In addition to the Harper Sand Gas Pool, Transco has been purchasing and will continue to purchase gas produced from the Vermilion Block 370 Field, located in Offshore Louisiana. Transco has not cut back its takes from the Vermilion Block 370 Field because Transco has prepaid for these volumes under contractual take-or-pay obligations. It has taken higher levels of production from this source than it otherwise would have taken in order to recoup the prepaid volumes. At the time Transco made prepayments for gas not taken from the Vermilion Block 370 Field, it paid the then current maximum lawful price (MLP) under Title I of the NGPA. When Transco later made up the prepaid volumes, it paid an additional amount of money representing the increase in the MLP over the

MLP in effect at the time Transco made the prepayments.

What is here now designated as the Mississippi-Louisiana Issue, is the second part of a three-part proceeding involving recent rate filings by Transco. The first part, designated the Sulpetro Issue, was the subject of an Initial Decision by me on September 3, 1985 (32 FERC ¶ 63,081). I there concluded that Transco should be permitted to recover in its purchased gas adjustment (PGA) filings the cost of Canadian gas purchased from Transco's Canadian supplier, Sulpetro, on an "as-billed" basis. The third part of the proceeding will deal with Transco's other purchase practices as provided for in the Commission's Order of April 30, 1985. A hearing on that issue was held before me on October 22, 1985. It was unnecessary to hold a hearing on the Mississippi-Louisiana Issue because the parties involved, Transco and Associated Gas Distributors (AGD), have entered into a Stipulation of Facts, Exhibit 1, as supplemented with prepayment data on July 26 and August 8, 1985, Exhibits 2 and 3. Transco, AGD and Staff have filed briefs herein.

This proceeding began on September 28, 1984 when Transco filed various tariff sheets to implement its PGA pursuant to the terms of its FERC Gas Tariff. On March 29, 1985, Transco tendered for filing its most recent PGA-type rate change. A number of parties, including AGD, raised issues concerning the justness and reasonableness of Transco's purchasing practices as they are reflected in its PGA. In its Order of April 30, 1985, the Commission acknowledged these protests and ordered the PGA dockets to hearing. Since the Mississippi-Louisiana Issue was the subject of a Stip-

ulation between the parties affected, this issue has been separated out from other purchase practices of Transco and will be the subject of this Initial Decision.

II. THE ISSUES PRESENTED AND THE POSITION OF THE PARTIES

Two issues are presented by the Stipulation of Facts, a copy of which is appended hereto as Appendix A:

1. Whether Transco's gas purchases in the Greens Creek and East Morgantown fields in Marion County, Mississippi, which are subject to a ratable take order of the State Oil and Gas Board of Mississippi, have been imprudent and have resulted in unjust and unreasonable rates.

2. Whether a producer or producers delivering make-up gas to Transco from the Vermilion Block 370 field received for that gas a price in excess of the maximum lawful price allowed by Title I of the NGPA, 15 U.S.C. § 3311-3320 (1982).

AGD and Staff take the position that Transco's compliance with the State Oil and Gas Board of Mississippi's order results in unlawful Transco rates. Specifically, AGD states at page 14 of its Initial Brief:

> The Mississippi ratable take order obligates Transco to take gas ratably from all owners, operators, and producers—both signatory and nonsignatory—who produce gas from the Harper Sand Gas Pool, if it takes any gas from that source at all. Transco acknowledges tht the practical effect of compliance with this order is that it must either reduce its takes from those producers with whom it has contracts, thereby incurring increased take-or-pay liabilities, or increase its total takes of this

> high-cost gas to amounts which it did not plan for and perhaps may not be able to sell to its customers. Either alternative is inconsistent with a "least reasonable (sic) cost" gas purchasing policy. Transco's compliance with the ratable take order therefore constitutes a continuing situation of imprudent purchasing practices in violation of NGA Section 4 and 5. *It is imperative that the Presiding Judge and the Commission take immediate action to declare unlawful an interstate pipeline's adherence to a state law which frustrates the pipeline's ability to comply with its federal statutory responsibilities.* (Emphasis supplied)

On the other hand, Staff argues in its Initial Brief at pages 15-16 that:

> * * * Transco's purchases made pursuant to Mississippi Rule 48 should be found to be unjust and unreasonable because Rule 48 prevents Transco from pursuing a least-cost purchasing strategy and results in higher costs being passed on to the ultimate consumers. The Commission should therefore exercise its exclusive jurisdiction over Transco's purchasing practices and direct Transco to pursue a least-cost purchasing strategy *irrespective of Rule 48.*

As to the second or Title I issue, both the Staff and AGD contend that Transco's prepayments for Vermilion Block 370 gas violates Title I of the NGPA because the time value of the money received by the producer from such prepayments, when added to the payments made by Transco at the time that the gas is actually taken, exceeds the maximum lawful price under Title I of the NGPA, 13 U.S.C. §§ 3311-3333.

For a remedy, Staff states that the *producers* should refund the $3.3 million figure claimed to represent the time value of money received by such producers for Transco's prepaid Vermilion Block 370 gas. AGD, on the other hand, states that *Transco* should be denied passthrough of such amounts and that Transco should refund the $3.3 million to its customers.

Transco, of course, resists these contentions, arguing that it cannot disregard the Mississippi Board's order under Rule 48 which Transco has appealed all the way to the United States Supreme Court. On the Title I issue, Transco states that the time value of prepayments is a generic problem which should be addressed on an industry-wide basis. Transco also argues that Title I problems do not belong in PGA proceedings because relief runs not against the purchaser, here Transco, and is not properly administered through the PGA mechanism.

III. DISCUSSION

It seems obvious to me that if we are to continue to follow the rule of law in this country, a party should not be placed in jeopardy for obeying an order of a duly constituted authority while that party undertakes successive appeals seeking to overturn an adverse decision. Here Transco was ordered by the Mississippi Board to abide by Rule 48, a perfectly equitable method of handling gas production from the Harper Sand Gas Pool. Disagreeing with the Board's decision, Transco appealed under Mississippi law to the Circuit Court which upheld the Board. There followed an appeal to the Supreme Court of Mississippi which upheld the ratable take requirement in its decision of September 5, 1984, reported as *Transconti-*

nental Gas Pipeline Corporation, v. The State Oil and Gas Board of Mississippi, 457 So. 2d 1298 (Miss. 1984). Thereafter, Transco noticed its appeal to the Supreme Court of the United States where oral arguments were heard October 8, 1985 (No. 84-1076).

I am clear that the law of this case today lies in the decision of the Supreme Court of Mississippi and its holding will continue to govern this proceeding until the United States Supreme Court hands down its decision on appeal. It is simply not acceptable for AGD and Staff to direct Transco to ignore and even flout the Mississippi holdings and require Transco to conduct its affairs *"irrespective of Rule 48."* In my view, Transco is entitled, indeed is required, to follow the decisions and orders of the Mississippi authorities until and unless they be overturned by the Supreme Court of the United States. Any other view would abrogate the rule of law and invite litigants to go about making up their own minds whether or not they would abide by decisions of duly constituted authority.

It also seems presumptuous for AGD and Staff to assume, as they apparently do, that the Supreme Court of the United States will automatically reverse the decision of the Supreme Court of Mississippi. The state court's decision is a powerful statement in support of the legality of Rule 48 as here applied. AGD and Staff beg the question in arguing from the premise that "the federal law in this case preempts all conflicting state regulation." AGD Initial Brief 21; Staff Initial Brief 8-13. The result of the Court's deliberation is hardly a foregone conclusion. It is likely that the court will review this constitutional issue broadly, since it is primarily a question of law rather than fact, and it involves one of FERC's own authorization

statutes. *Hi-Craft Clothing Co.* v. *NLRB*, 660 F.2d 910, 914-16 (D.D.C. 1981) (citing U.S. Supreme Court cases); 5 K. Davis, *Administrative Law Treatise*, § 29:14 (2d ed. 1984). Further, recent decisions indicate the Court's increased willingness to review the validity of state and federal agency policy. Davis, *supra* § 29:15. At any rate, the proper time for this Commission to act is after the Supreme Court decides the case at which point all concerned may be guided accordingly.

As to the second or Title I issue, I agree with Transco that this is not the time and place to become involved in the question of the legitimacy of payments which allegedly did not properly account for their time value. Of paramount consideration in this regard is the absence from this proceeding of the producers who may be required to disgorge any monies in excess of the limits provided in the NGPA. Justice certainly requires that the interests of producers be considered. Yet Staff would have me direct the producers, names unknown on this record, to refund the amounts represented by the time value of Transco's prepayments, a total of $3,380,685.74. (Staff Initial Brief, pp. 21-22). AGD would go further by demanding that Transco pay these refunds and, prospectively, not pass the excessive amounts through to its customers. (AGD Initial Brief, pp. 32, 34). It is noted that AGD in its Reply Brief softens this demand for relief by recommending that the Presiding Judge should make Transco's compliance actions ". . . coincide with its receipt of refunds from its supplier or suppliers of gas from the Vermilion Block 370, the latter to occur as a result of such enforcement or other proceedings as are chosen by the Commission." (Reply Brief, pp. 11-12). These

suggestions are rejected. Far better is the suggestion that time value problems be the subject of a separate Commission generic investigation wherein the interests of all parties may be presented and an informed decision be promulgated.

In its Reply Brief Staff asserts that the only Louisiana producer affected by the outcome of this proceeding is Shell Offshore, Inc. which is a party herein and presumably fully knowedgeable on this issue. I am reluctant to accept this argument, primarily because the Stipulation of Facts upon which this decision is based does not state that Shell is the only producer affected by this proceeding; indeed it identifies no producers.

IV. CONCLUSION

It follows that, subject to review by this Commission, I find:

1. Transco's purchase practices of volumes from the Greens Creek and East Morgantown fields have not been imprudent and have not resulted in unjust and unreasonable rates.

2. Based on the record in this proceeding, this is not the proper forum to consider problems involving the time value of money for prepayment of gas in the Vermilion Block 370 Field as proposed by AGD and staff.

/s/ THOMAS I. MEGAN
Thomas I Megan
Presiding Administrative Law Judge

Appendix A

STIPULATION OF FACTS

Associated Gas Distributors (AGD) and Transcontinental Gas Pie Line Corporation (Transco) stipulate that the following facts are true, that they are jointly tendered, and that they are admissible into evidence in lieu of testimony. The entry of this stipulation is limited solely to those matters expressly provided herein and shall not signify any agreement by the parties that all of the facts stipulated herein are material or relevant to the issues in this proceeding, or that all of the subject matters covered hereby are appropriate issues in this proceeding, nor shall the entry of this stipulation act as a bar to any rights of the parties hereto including, but not limited to, the right to object to the materiality or relevance of any matters stated herein.

A. Mississippi Volumes

1. During the periods covered by the two PGA filings in the instant dockets, Transco has purchased and will purchase gas produced from the Greens Creek and East Morgantown fields in Marion County, Mississippi.[1]

2. Portions of both the Greens Creek Field and the East Morgantown Field are underlied by the Harper Sand Gas Pool.

3. The Harper Sand Gas Pool lies below 15,000 feet. All of the wells producing from this pool have been

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[1] *See*, for example, Transco Tracking Rate Filing to be Effective November 1, 1984, Appendix C at 152 *et seq.* and 167 *et seq.*

classified as "dereguated deep, high-cost wells" under § 107(c)(1) of the NGPA, 15 U.S.C. § 3317(c)(1) (1982).

4. Transco has natural gas supply contracts with Mississippi producers whose gas wells produce from the Harper Sand Gas Pool.

5. Most, if not all, of Transco's supply contracts for gas produced from the Harper Sand Gas Pool contain take-or-pay clauses.

6. Transco does not have supply contracts with all producers who own interests in the Harper Sand Gas Pool.

7. In an enforcement proceeding brought against Transco, the State Oil and Gas Board of Mississippi (the "Mississippi Board"), acting pursuant to Statewide Rule 48, ordered Transco to take gas ratably from all owners, operators, or producers in the Harper Sand Gas Pool. This order was upheld on appeal of the Mississippi court of appeals and, thereafter, the Mississippi Supreme Court. The merits of this order are now pending review by the U.S. Supreme Court in Transcontinental Gas Pipe Line Corp. v. The State Oil and Gas Board of Mississippi *et al.*, No. 84-1076.

8. Under the Mississippi Board's ratable take rule, if Transco takes gas at any time from the Harper Sand Gas Pool producers with whom it has contracts (the signatory producers), it was ordered to take gas in volumes which equate to the same percentage of each producer's working interest in the Harper Sand Gas Pool from producers with whom Transco does not have contracts (the nonsignatory producers). Under the Mississippi Board's order, Transco has been

ordered to take more deregulated gas from the Harper Sand Gas Pool than Transco contracted or planned for.

9. If Transco reduces its takes from the signatory producers to account for the corresponding volumes it has been ordered to take from nonsignatory producers, Transco may incur take-or-pay liabilities on those contracts which contain take-or-pay clauses.

B. Payment Makeup Volumes

1. During the periods covered by the two PGA filings in these two dockets, Transco has purchased and will purchase gas produced from the Vermillion 370 Field, located in offshore Louisiana.[2]

2. Transco has protected its takes from the Vermillion 370 Field against cutbacks in production because Transco prepaid for these volumes under take-or-pay contractual obligations. Therefore, Transco was required to take higher levels of production from this source than it otherwise would have taken in order to recoup the prepaid volumes.

3. At the time Transco made prepayments for gas not taken from the Vermillion 370 Field, it paid the maximum lawful price (MLP) under Title I of the NGPA, 15 U.S.C. §§ 3311-3320 (1982).

4. When Transco received the volumes from the Vermillion 370 Field for which it made prepayments, it paid, in addition, an amount of money which rep-

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[2] *See*, for example, Transco Tracking Rate Filing to be Effective November 1, 1984, Appendix C at 39 and 127.

resents the increase in the current minimum lawful price (MLP) over the MLP in effect at the time of Transco's prepayment.

Respectfully submitted,

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Dated: July 3, 1985
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